SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1934

FOUNDERS GENERAL CORPORATION,
Petitioner, and
Plaintiff-Appellant below,

against

JAMES J. HOEY, Collector of United States Internal Revenue for the Second District of the State of New York,
Respondent, and
Defendant-Appellee below.

BRIEF IN SUPPORT OF PETITION FOR WRIT OF CERTIORARI

Opinions of the Courts Below

The opinion of the District Court for the Southern District of New York dismissing the complaint upon the ground that it fails to state a cause of action, is dated September 10, 1935 and is found at page 27 of the record. It is reported at 12 Fed. Supp. 290. The opinion of the Circuit Court of Appeals for the Second Circuit is dated July 6, 1936 and is found at page 45 of the record. It has not yet been officially reported.

Jurisdiction

The statute granting the power to review herein is U. S. Code, Title 28, §347 (Judicial Code §240). The date of the decision and judgment to be reviewed is July 6, 1936.

Statement of the Case

The statement of the case has been given under heading I in the petition submitted herewith and hence the statement is not repeated here.

Specification of Error

The Circuit Court of Appeals for the Second Circuit erred in affirming the order and judgment of the District Court for the Southern District of New York dismissing the complaint upon the ground that it failed to state a cause of action, in that the transaction set forth in the complaint was not a taxable transfer under Schedule A, subdividion 3 of Section 800 of the Revenue Act of 1926, and the complaint sets forth a cause of action to recover taxes erroneously assessed and paid under protest.

The Statute

The transfer tax imposed by Schedule A, subdivision (3), Section 800 of the Revenue Act of 1926, C. 27, 44 Stat. 99, 101; U. S. C. Title 26, Secs. 900, 901, *et seq.*, reads as follows:

> "3. Capital stock, sales or transfers: On all sales or agreements to sell, or memoranda of sales or deliveries of, or transfers of legal title to shares

or certificates of stock or of profits or of interest in property or accumulations in any corporation, or to rights to subscribe for or to receive such shares or certificates, whether made upon or shown by the books of the corporation, or by any assignment in blank, or by any delivery, or by any paper or agreement or memorandum or other evidence of transfer or sale, whether entitling the holder in any manner to the benefit of such stock, interest, or rights, or not, on each $100 of face value or fraction thereof, 2 cents, and where such shares are without par or face value, the tax shall be 2 cents on the transfer or sale or agreement to sell on each share:

"*Provided,* That it is not intended by this title to impose a tax upon an agreement evidencing a deposit of certificates as collateral security for money loaned thereon, which certificates are not actually sold, nor upon the delivery or transfer for such purpose of certificates so deposited, nor upon mere loans of stock nor upon the return of stock so loaned:

"*Provided further,* That the tax shall not be imposed upon deliveries or transfers to a broker for sale, nor upon deliveries or transfers by a broker to a customer for whom and upon whose order he has purchased same, but such deliveries or transfers shall be accompanied by a certificate setting forth the facts:

"*Provided further,* That in case of sale where the evidence of transfer is shown only by the books of the corporation the stamp shall be placed upon such books; and where the change of ownership is by transfer of the certificate the stamp shall be placed upon the certificate; and in cases of an agreement to sell or where the transfer is by delivery of the certificate assigned in blank there shall

be made and delivered by the seller to the buyer a bill or memorandum of such sale, to which the stamp shall be affixed; and every bill or memorandum of sale or agreement to sell before mentioned shall show the date thereof, the name of the seller, the amount of the sale, and the matter or thing to which it refers.

"Any person liable to pay the tax as herein provided, or anyone who acts in the matter as agent or broker for such person, who makes any such sale, or who in pursuance of any such sale delivers any certificate or evidence of the sale of any stock, interest or right, or bill or memorandum thereof, as herein required, without having the proper stamps affixed thereto, with intent to evade the foregoing provisions, shall be deemed guilty of a misdemeanor, and upon conviction thereof shall pay a fine of not exceeding $1,000, or be imprisoned not more than six months, or both."

ARGUMENT

POINT I

There was no transfer by the plaintiff to Benton & Co. of the legal title to rights to receive the shares or certificates from United States Electric Power Corporation.

The plaintiff directed that the certificates for 100,000 shares should be issued in the name of its nominee prior to payment therefor as a convenience to itself with reference to future sales to the public.

Until payment was made for the stock there was no right to receive the stock either by the plaintiff or by any-

body else. At the time that payment was made for the stock, by plaintiff, the certificate was delivered directly to the plaintiff in the name of Benton & Co. At all times plaintiff was the only person entitled to receive the stock upon payment therefor. The nominee never received the possession of the certificate. Nor was the endorsement of the nominee necessary to assign the certificate, for the plaintiff had full power as attorney-in-fact to endorse the certificate by the agreement (Record, fol. 48). The terms of the partnership agreement and of the agreement between the plaintiff and the partnership not only expressly disclaimed any beneficial interest in the stock whatsoever on the part of Benton & Co. but expressly disclaimed on the part of the nominee "all right, title, interest, lien, claim and demand" to the stock whatsoever. Benton & Co. was the alter ego and agent only of the plaintiff, which at all times had all right, title and interest, legal, equitable and beneficial, to the stock in question and the right to receive and hold the certificates.

The Court will take judicial notice of the fact that stock in the name of a corporation is not good delivery under ordinary business practice unless accompanied by certified copies of resolutions of the Board of Directors or Executive Committee of the corporation authorizing the delivery and sale of the specified shares represented by the certificate sold. It has been the universal practice to have all corporations engaged in the purchase and sale of stock, or indeed those corporations holding stock, to have the same registered in the name of their agents or nominees, either as an individual or partnership nominee.

In February, 1928, the United States first asserted a claim for taxes upon what it termed "the invisible trans-

fer" of the right to receive shares purchased by a corporation to its nominee. The facts were squarely presented and decided in *Union Trust Co. of Pittsburgh* v. *Heiner*, decided in the District Court for the Western District of Pennsylvania, February 8, 1928 (26 Fed. [2nd] 391).

The facts in the *Heiner* case were as follows (p. 391):

> "On November 27, 1922, the plaintiff entered into a written agreement with one B. F. Jones, Jr., whereby it agreed to purchase, at the option of said B. F. Jones, Jr., certain stock of Jones & Laughlin Steel Corporation, to be delivered to the plaintiff, or its nominee or nominees. Jones exercised the option, and the stock involved was issued at the request of the plaintiff to one James M. Kommer, an employee of the plaintiff. As a matter of fact, Kommer had no interest in the stock in question, and merely took title to the stock for the convenience of the plaintiff, in connection with future sales and transfers of the stock to the public. Tax stamps required to be placed on the original issue of stock were placed on that issued to Kommer. The government compelled the plaintiff to pay stamp tax of $3,428.04 upon the instrument, nominating Kommer to receive the stock in question. Due demand was made upon the Commissioner of Internal Revenue for the refundment of this amount, and the same has not been refunded; whereupon the plaintiff brought this suit to recover what it contends is an illegal exaction of stamp taxes from it."

The Government contended in the *Heiner* case that the nomination of Kommer by the plaintiff to take title for it to the stock in question was the delivery to him of a "right to receive" the shares, and therefore taxable. These

facts were set forth in the complaint to which the defendant demurred. The court (Judge Schoonmaker) over ruled the demurrer stating (p. 391):

> "* * * In our opinion, there was but one transaction involved in this issue of stock. *There was no transfer of any rights in this stock to Kommer. He was the mere employee and agent of the plaintiff, appointed to receive and hold this capital stock for the sole and exclusive benefit of the plaintiff.* He had no beneficial interest whatever in the stock. We are of the opinion that the facts disclosed by the statement of claim present a case of an illegal exaction of a stamp tax from the plaintiff in this case." (Italics ours.)

There was no appeal by the Collector represented by the United States Attorney from the decision in the *Heiner* case. *From 1928 until 1934 the Heiner case remained as the sole authoritative judicial determination of the Revenue Act of 1926 upon the point in question.* Not until 1934, six years after the *Heiner* ruling, did the government assert, so far as the petitioner is concerned, that stamp taxes were due upon the issuance of stock in the name of an individual or partnership nominee or dummy. In the meantime thousands of similar transactions had occurred.

Since 1934 the government has tried repeatedly in various jurisdictions to obtain a ruling contrary to that of the *Heiner* case, so that it might now tax as taxable all such transactions which have been carried out as nontaxable under the only judicial interpretation of the act in the law books. It has been, until the decision in the instant case, uniformly unsuccessful.

The *Heiner* decision has been followed in *Dean* v. *Caldwell Co.*, 9 Fed. Supp. 177 (District Court M. D.

Tennessee, decided March 19, 1934, by Judge Gore), and again in the recent cases of *Field, Glore & Co.* v. *United States of America,* decided April 8, 1935, by Judge Barnes, in the District Court of the United States for the Northern District of Illinois, Eastern Division (Reported in Commerce Clearing House—Federal Tax Service, Vol. III-A, 1935, pp. 9803-9806), and in *A. B. Leach & Co.* v. *United States,* decided in the Northern District of Illinois, Eastern Division on July 16, 1935 by Judge Holly. (Reported in Commerce Clearing House—Federal Tax Service, Vol. 3-A, 1935, pp. 10583-10584.) The same question was presented in *National Bond & Share Co.* v. *Hoey,* 14 Fed. Supp. 787 decided adversely to the Collector of Internal Revenue by Judge Patterson in the Southern District of New York on April 15, 1936. Five district court judges have, therefore, decided this precise point against the United States.

The court below referred to *Union Trust Company* v. *Heiner* and stated:

> "It is plain that the court in *Union Trust Company* v. *Heiner* ignored the express provision that the absence of any beneficial interest on the part of the holder should not exempt the transfer from taxation. The decision, therefore, proceeded on an indefensible theory. That decision has since been followed by various district courts, but we cannot avoid the conclusion it is contrary to the plain meaning of the statute".

We think that this is an incorrect deduction from the opinion in the *Heiner* case in that the decision, as in the *Leach* decision in the Seventh Circuit, hereafter referred to, the court had held that there was no transfer of *any rights* in the stock to the nominee.

Although the Court of Appeals for the Second Circuit affirmed Judge Goddard's opinion in this case, the affirmance rested upon a different interpretation of the statute from that adopted by Judge Goddard. In Judge Goddard's opinion he stated that the tax could not be sustained on the theory that in legal effect the transaction was the same as though the plaintiff had taken legal title to the shares and transferred them to its nominee, but then said:

> "But it can be sustained, in my opinion, on the theory that the nomination of Benton & Company as the person to whom the certificate was to be issued, falls within the exact letter of the statute taxing 'transfers of legal title to * * * rights * * * to receive such shares or certificates'" (Record, fol. 95).

It is thus apparent that Judge Goddard held that to find a transaction taxable, it must fall within the transfer of the *legal title* to rights to receive such shares or certificates. This test of the transfer of the legal title to the rights to receive the shares or certificates was discarded by the Circuit Court of Appeals. In that opinion the court referred to the expression "legal title" as used in a New York case, and quoted an excerpt from the opinion in which the New York Court had stated that that expression must be held to signify the appearance of title as distinguished from a full and complete title, and said:

> "Thus the New York courts sustained a tax upon the theory that there was a transfer to the nominee not merely of possession, but of the very title to the shares as the term 'title' was used in the statute. *We only have to go so far as to hold that there was a disposition of the right to receive.*" (Italics ours.) (Record, ~~fol~~ R 50.)

The reference to the New York decision is to the *Bonbright* case, 165 App. Div. 640, in which there was a transfer on the corporate books of certificates from a stockholder to a trustee and delivery of the stock certificate. The taxpayer claimed that there was no full and complete legal title vested in the trustee, and the court held that the transfer of legal title and possession was sufficient to impose a tax. The facts are entirely different from those here presented.

Be that as it may, however, the court below did not go so far as to hold that the legal title of the rights to receive the shares had been transferred by the plaintiff to its nominee, Benton & Company, but held that it was sufficient to make the transaction taxable, if there was "a disposition of the right to receive". This is a distortion of the statute which is not justified, for plainly the phrase "or to rights to subscribe for or to receive such shares or certificates" refers back to and is appended to the previous phrase which makes taxable "transfers of legal title to shares or certificates of stock or of profits or of interest in property or accumulations in any corporation", otherwise it is ungrammatical and meaningless. Judge Goddard's interpretation of the test of the statute as "transfers of legal title to * * * rights * * * to receive such shares or certificates" was a correct interpretation of the statute, even if incorrectly applied in the instant case. The act taxes transfers of legal title, not the transfer of the appearance of title, or a "disposition of the right to receive." The decision of the Court of Appeals for the Second Circuit, however, declares that this transaction was taxable not because there was a transfer of the legal title of the rights to subscribe, but because there was a transfer of "a disposition of the

right to receive". The opinion of the court below reads something into the statute which is not there.

The opinion in *United States* v. *Leach* decided by the United States Circuit Court of Appeals for the Seventh Circuit on June 30, 1936, just a week prior to the decision in the instant case, is to the exact contrary. In that case a firm of investment brokers subscribed for the capital stock of a newly formed corporation and caused it to be issued in the name of their nominee for convenience in contemplated sales to the public. The government assessed an additional tax on the alleged transfer of the right to receive the shares from the investment brokers to their nominee, which tax was paid in protest and was sought to be recovered in an action. The Court said:

> "We agree with appellee in its contention. We see no material distinction between the situation where a taxpayer takes title to stock in its own name, and where it uses the name of an agent. Certainly this does not present the shortcut in transfer of interest held taxable in the case of *Raybestos-Manhattan Co.* v. *United States*, 296 U. S. 60. Here there is no such shortcut, for there is no transfer, either of legal title or of beneficial interest. We do not consider that the transaction whereby a principal uses the name of an agent in acquiring title to a property which it was entitled to acquire in its own name, results in a transfer of the title to that property to that agent. *By such a transaction the taxpayer relinquishes nothing, and its agent receives nothing.* The only transfer which has taken place here is from the newly organized corporation to the taxpayer in the name of the agent or nominee of the latter. The conclusion here reached is in accord with the decision of *Union Trust Co.* v. *Heiner*, 26 F. (2d) 391

(D. C. W. D. Pa.) with which we agree. Cf. *United States* v. *Uhlmann Grain Co.*, decided by this court June 18, 1936."

Moreover, the statement of the court below that there was "a disposition of the right to receive the stock" is not borne out by the evidence. Benton & Company never had the right to receive the stock—in fact they never did receive the stock certificates which were delivered to the plaintiff upon payment therefor. By the agreement with the plaintiff and by the partnership agreement all right, title and interest in the stock was disclaimed, and in addition the plaintiff was appointed the attorney-in-fact of the partnership so that even if the certificates were registered in the name of Benton & Company, the plaintiff at all times had the power to dispose of the certificates without even requesting Benton & Company to endorse the certificates, which, however, Benton & Company under the agreement with the plaintiff, agreed to do at all times upon request.

Whenever a person subscribes to stock of a corporation he as subscriber has the right upon payment to have the stock certificates issued either in his name or in the name of his nominee and not merely in his name alone; therefore, when such subscriber directs that the certificates be issued in the name of a nominee he is not giving up any right by transferring it to another, but merely stating how his original transaction of subscription shall be carried out. He is not foregoing an exclusive right to have the certificates issued in his name and thereby transferring this right to someone else by taking such a step. The step of having the stock issued in the name of a nominee is merely a completion of the transaction of issuance of the stock upon which the issue tax was paid and does not constitute a transfer of anything.

It has been stated that a disposition of the right to receive is not a test of taxability. It is only the transfer of the legal title of the right to receive, which the statute makes taxable, and there was no transfer of the legal title where the principle has a security registered in the name of a dummy and at all times retains possession and control of the certificates.

The transfer of title to a stock certificate under the law of New York is governed by Section 162 of the Personal Property Law of New York as follows:

> "Title to a certificate and to the shares represented thereby can be transferred only,
>
> "(a) By delivery of the certificate indorsed either in blank or to a specified person by the person appearing by the certificate to be the owner of the shares represented thereby, or
>
> "(b) By delivery of the certificate and a separate document containing a written assignment of the certificate or a power of attorney to sell, assign or transfer the same or the shares represented thereby, signed by the person appearing by the certificate to be the owner of the shares represented thereby. Such assignment or power of attorney may be either in blank or to a specified person.
>
> "The provisions of this section shall be applicable although the charter or articles of incorporation or code of regulations or by-laws of the corporation issuing the certificate and the certificate itself provide that the shares represented thereby shall be transferable only on the books of the corporation or shall be registered by a registrar or transferred by a transfer agent."

Even if the shares be regarded as having been transferred to the nominee in trust for the plaintiff, under the

Real Property Law of New York, Section 93, which is equally applicable to personal property (*Matter of DeRycke*, 99 App. Div. 596; *Matter of Bell*, 141 Misc. 720), the trust was a dry or passive trust which under the statute vested title in the beneficiary, the plaintiff, immediately.

POINT II

The recent decision in the United States Supreme Court in the case of *Raybestos-Manhattan Co.* v. *United States*, 296 U. S. 60, 80 Law. ed. 42, is distinguishable from this case.

The facts in the *Raybestos* case are stated in the opinion as follows (p. 42, Law. ed.):

> "Petitioner was organized under the laws of New Jersey as a step in carrying out a plan and agreement for the consolidation of three other corporations. Two of the corporations conveyed their property to petitioner in return for a specified number of its shares of capital stock, issued not to the two corporations, but directly to their stockholders in proportion to their holdings."

The liability for the tax levied on the original issue of the stock was conceded, but it was not conceded that the transaction involved any taxable transfer within the purview of Schedule (A) (3).

In rendering the opinion that there was a transfer tax, Mr. Justice Stone said at page 43, Law. ed.:

> "The stock transfer tax is a revenue measure exclusively. Its language discloses the general purpose to tax every transaction whereby the right to

be or become a shareholder *or to receive any certificate of any interest in its property is surrendered by one and vested in another.* See *Provost* v. *United States*, 269 U. S. 443, 458, 459, 70 L. ed. 352, 356, 357; 46 S. Ct. 152. While the statute speaks of transfers, it does not require that the transfer shall be directly from the hand of the transferor to that of the transferee. It is enough if the right or interest transferred is, by any form of procedure, relinquished by one and vested in another. Even the ownership of a share of stock, transfer of which is admittedly taxed, is not transferred directly from one to another as is title to a chattel or to real estate. Transfer of title to the shares is effected by a form of novation by which the right of the shareholder is surrendered to the corporation in return for its recognition of a new shareholder designated by the transferor and the issue to him of a new certificate of stock. *It is relinquishment of the ownership for the benefit of another, and the resultant acquisition of it by him which calls the statute into operation.*" (Italics ours.)

No rights in the stock involved in this case, either legal or equitable, were surrendered by petitioner, or vested in its nominee.

The facts in the *Raybestos* case and in the *Provost* case show that there was a real double transfer of the legal title to and beneficial interest in stock which the taxpayers tried to short-cut by one transfer. Where a corporation sold its assets for stock, the following transactions occurred:

(1) The purchasing corporation issued its stock.

(2) The selling corporation was entitled in law to receive the stock and could either hold it in its treasury

or receive the stock constituting payment and then distribute the stock received among its own shareholders.

(3) In the case above specified, the selling corporation authorized the purchasing corporation to issue its stock not to the purchasing corporation *but directly to the stockholders of the seller.* In other words, there was a transfer not only of the legal title to and beneficial interest in the stock from the issuing corporation to the selling corporation, but an actual transfer of legal and beneficial interest in the stock and the right to receive the stock from the selling corporation to its stockholders.

In the instant case, Founders General Corporation never relinquished any ownership of the shares for the benefit of anyone else than Founders General Corporation. There was no resultant acquisition by Benton & Co. of any rights or ownership. Nothing was ever transferred to Benton & Co., not even the certificate representing the stock nor was the legal title or any beneficial interest therein vested in Benton & Co.

POINT III

The New York cases cited in the opinion below depend upon the New York statute, and are distinguishable both on the law and the facts.

These cases were *Bonbright & Co.* v. *State of New York,* 165 App. Div. 640, and *Travis* v. *Ann Arbor Co.,* 180 App. Div. 799, affirmed 227 N. Y. 640 without opinion.

The New York law construed in the *Bonbright* case imposed a tax upon any and all deliveries and transfers of

stock "whether investing the holder with the beneficial interest in or legal title to said stock * * * or merely with the possession or use thereof for any purpose" (New York Tax Law, Section 270). By agreement with a trust company, and in order to provide for the exercise of certain options to repurchase the stock, the trust company was vested with the legal title to 100,000 shares of stock for ten years, and the trust company was required to issue immediately to the owners of the 100,000 shares, certificates of beneficial interest. At the time of the execution of the agreement, the certificates of stock were physically delivered and the stamp tax paid: The certificate for 100,000 shares was surrendered and a new certificate issued to the trust company. The owners of certificates of beneficial interest for 71,308 shares, which were not under repurchase options, sued to recover the tax paid. This was clearly taxable. The transaction involved the transfer of the legal title to and the actual delivery and transfer on the books of certificates of stock.

Travis v. *Ann Arbor Co.* (*supra*) involved the transfer and cancellation and surrender of a stock certificate standing in the name of an accommodation holder and the issuance and delivery by the corporation of a new stock certificate in the name of a new accommodation holder. The *Ann Arbor* case would only be applicable if stock in the name of Benton & Co. had been surrendered to United States Electric Power Corporation and new certificates of stock in the place thereof issued in the name of, for instance, "Smith & Co.," a new nominee of the plaintiff. *There was a transfer on the books of the corporation from one stockholder to another.*

In addition it should be pointed out that Section 270 of the New York Tax Law as it existed November 27, 1922, was broader than the Federal statute under discussion, in that it applied to any and all deliveries or transfers of shares or certificates of stock *"whether investing the holder with beneficial interest in or legal title to such stock, or merely with the possession or use thereof for any purpose."* (Italics ours.)

Conclusion

Petitioner therefore respectfully prays that a writ of certiorari issue to review the decision of the Circuit Court of Appeals for the Second Circuit.

The attempted collection of a tax in this case has all of the elements which have so long condemned *ex post facto* laws in our jurisprudence.

In 1928 the United States District Court in the *Heiner* case, decided flatly that a transaction such as this was nontaxable. The United States failed to appeal, and for six years the decision stood unchallenged. During that time it was followed presumably by thousands of other taxpayers as well as the plaintiff. In the claim for refund made by the plaintiff it is stated not only that the tax liability and penalty assessed is not justified under the law, but that it is contrary "to the decision of the United States District Court for the Western District of Pennsylvania in *Union Trust Company* v. *Heiner,* 26 Fed. (2nd) 391, *upon which claimant relied in failing to pay a tax upon the alleged transfer at the time the stock was issued as aforesaid"* (Record, fol. 72).

The United States is attempting in this case to make a transaction taxable which, under the only judicial decision in existence at the time it occurred, was non-taxable. Every consideration of law and justice requires that the decision of the court below should be reversed.

The solicitor general has petitioned for a writ of certiorari in *United States* v. *A. B. Leach & Co.*, No. 331, September, 1936, and it is respectfully prayed that the cases, if the writs are granted, be heard together.

Respectfully submitted,

ROYAL E. T. RIGGS,
Counsel for Petitioner.

September, 1936.